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PSCSC DOCKET NO. 2005-191-E

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2 **A.** My name is Janice D. Hager. My business address is 526 South Church Street, Charlotte,
3 North Carolina. I am Vice President, Rates and Regulatory Affairs for Duke Power, a
4 division of Duke Energy Corporation (“Duke Power” or “the Company”).

8 **A.** I am a civil engineer, having received a Bachelor of Science in Engineering from the
9 University of North Carolina at Charlotte. I began my career at Duke Power in 1981 and
10 have had a variety of responsibilities across the Company in areas of piping analyses,
11 nuclear station modifications, new generation licensing, Integrated Resource Planning and
12 Demand Side Management. I joined the Rate Department in 1996 and my initial
13 responsibilities included implementation of Duke Power's Open Access Transmission
14 Tariff. I was promoted to Manager, Rate Design, and in 1999, to Manager, Rate Design and
15 Analysis, with responsibility for the Rate Design, Revenue Analysis and Load Research
16 groups. In 2003, I was promoted to the position of Vice President of Rates and Regulatory
17 Affairs for Duke Power. I am a registered Professional Engineer in North Carolina and

1 South Carolina and am chair of the Southeastern Electric Exchange Rates and Regulation
2 Section.

3
4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

5 **A.** The purpose of my testimony is to address the issues raised by the Public Service
6 Commission of South Carolina ("Commission") in this generic docket on behalf of Duke
7 Power. I will specifically address whether the Commission should implement a formal
8 Request for Proposal ("RFP") process. I will also discuss the current use of RFPs by Duke
9 in its supply side procurement process and the need for flexibility in the evaluation of bids.
10

11 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

12 As a utility regulated by this Commission, Duke has a significant interest in the policy that
13 the Commission develops in regard to RFPs. Duke also has significant experience that may
14 be helpful to the Commission in determining if a formalized process is necessary. Duke
15 believes that a competitive procurement process is one of several valuable tools that the
16 Company can use to benefit its customers. Based upon our experience, Duke believes that a
17 formalized Commission requirement to issue RFPs for every new resource addition is
18 unnecessary, and if not appropriately flexible, may have the effect of adding cost rather than
19 reducing cost for customers.
20

21 As I will discuss in my testimony, customers are best served by a resource planning process
22 which allows the utilities regulated by the Commission to have flexibility in resource
23 acquisitions. A mandatory requirement for the use of RFPs will unnecessarily limit that

1 flexibility and could result in lost market opportunities. Duke currently utilizes RFPs for
2 some new resource acquisitions and is looking at expanding that use when it makes
3 economic sense for our customers. As Duke has demonstrated over the past ten years, the
4 Company will utilize RFPs when we believe that the use of this device will benefit our
5 customers.

6
7 The Commission should not implement rigid evaluation criteria or restrict the utilities'
8 discretion in the evaluation process. Much like the RFP requirement itself, the evaluation
9 should allow the utility flexibility to select the resources that meet the unique characteristics
10 of each need being sought. The Commission currently has significant regulatory
11 mechanisms in place to oversee the Company's resource planning process and to check the
12 prudence of the utilities' resource acquisition decisions without a mandatory process.

13 14 **I. BACKGROUND**

15 **Q. PLEASE EXPLAIN THE GENESIS OF THIS GENERIC PROCEEDING.**

16
17 **A.** On January 6, 2005, the Commission issued its Final Order in Docket No. 2004-178-E,
18 Application of South Carolina Electric & Gas Company's ("SCE&G") Electric Rate
19 Schedules and Tariffs. That Order approved an increase in electric rates and charges for
20 SCE&G and also approved the inclusion of the entire cost of constructing the Jasper
21 Generating Project ("Jasper") in SCE&G's rate base. Jasper is a self-build three unit 850
22 MW natural gas plant that went on line May 1, 2004. As part of the Commission Order in
23 Docket No. 2004-178-E, the Commission considered four questions in regards to Jasper:

- 24 (a) Should the remainder of the Jasper investment (that is, the remainder
25 after \$276 million previously allowed) be included in rate base?

1
2 (b) Did the Company properly annualize contracts with the North Carolina
3 Electric Membership Corporation ("NCEMC") as a result of the
4 completion of Jasper?
5

6 (c) Should the gas capacity contract related to Jasper be removed from the
7 fuel component of rates and placed into base rates?
8

9 (d) Should the Commission open a proceeding to investigate competitive
10 bidding for new generation?
11

12 **Q. WHAT DID THE COMMISSION DECIDE IN THAT DOCKET?**

13 **A.** Ultimately the Commission approved the entire value of Jasper, recognizing the 850 MW
14 facility was used and useful, that SCE&G was prudent in constructing Jasper, and that
15 Jasper created several economies of scale that ultimately benefited ratepayers. The
16 Commission also expressly rejected the idea that an RFP would have rendered a more
17 valuable option than Jasper.
18

19 **Q. WHAT DID THE COMMISSION DETERMINE AS IT RELATES TO QUESTION**
20 **(d)?**
21

22 **A.** In response to question (d), the Commission opened a generic docket to explore a formal
23 RFP process for utilities that are considering alternatives for adding generation. Although
24 Duke was not a participant in the underlying proceeding that led to the creation of this
25 generic docket, the Company understands that the Commission is soliciting opinions and
26 comments from all of its regulated utilities on the merits of a formalized RFP process.
27

28 **Q. WHAT MATTERS ARE TO BE ADDRESSED THROUGH THIS GENERIC**
29 **PROCEEDING?**
30

31 **A.** On June 24, 2005, the Commission issued its Notice of Generic Proceeding and Notice of
32 Hearing for Docket No. 2005-191-E. In that Notice, the Commission described the matters

1 to be covered through this generic proceeding. Specifically, the Commission said the
2 generic proceeding was initiated to “explore whether to implement a formal RFP process
3 for utilities that are considering alternatives for adding generating capacity and, if so, what
4 should be included in the RFP process and how RFPs should be evaluated.”

5
6
7
8 **II. THERE IS NO JUSTIFICATION FOR A**
9 **FORMALIZED COMPETITIVE BIDDING PROCESS.**
10

11 **Q. DO YOU BELIEVE THAT COMPETITIVE BIDDING CAN BE BENEFICIAL IN**
12 **THE IDENTIFICATION OF RESOURCES?**
13

14 **A.** Yes. There are times when the use of a competitive bidding process can be useful in
15 identifying resource options. In fact, Duke Power has used the competitive wholesale
16 market extensively over the past 10 or so years to satisfy peaking and, more recently,
17 intermediate capacity needs. However, as I discuss in my testimony, competitive bidding is
18 not always necessary to identify cost effective reliable resources.

19
20 **Q. DOES DUKE SUPPORT THE IMPLEMENTATION OF A MANDATORY**
21 **FORMAL RFP PROCESS BY THE COMMISSION?**
22

23 **A.** No, despite the potential benefits of RFPs, the Commission should not mandate or
24 formalize an RFP process to be used by the utilities that it regulates. Each individual utility
25 and its management must be allowed the flexibility to determine the best method for
26 procuring resources to meet customers’ needs. It is the utilities that bear the burden of
27 demonstrating to their regulators that they have acted prudently in meeting customers’
28 needs. At times, employing an RFP will be the best method to determine the least cost and
29 most reliable resource, and Duke has demonstrated a commitment to solicit bids when it
30 believes such action will result in benefits to customers. However, a mandatory formally

1 structured process is not necessary and could ultimately lead to lost opportunities and
2 increased cost for customers.

3
4 **Q. WHAT ARE THE DISADVANTAGES TO BEING REQUIRED TO ISSUE RFPs**
5 **FOR EVERY NEW RESOURCE ADDITION?**
6

7 **A.** The Company strives to procure the lowest cost, most reliable resources to meet our
8 customers' needs. As part of accomplishing this task the Company continuously monitors
9 the marketplace to ensure that our customers benefit from market conditions, including
10 opportunities to purchase wholesale power under short and long term contracts. Thus,
11 requiring an RFP for each new resource addition is unnecessary as our customers already
12 benefit from Duke's participation in the marketplace. A mandatory RFP requirement does
13 not increase our potential for finding superior market options, but restricts our flexibility
14 and could lead to additional costs. This cost includes the cost to develop and implement the
15 bidding process itself and would also include potentially significant costs associated with
16 any requirement to utilize independent monitors of the RFP process. In addition, the length
17 of the evaluation and selection process may adversely impact the timely availability of
18 capacity and can result in lost opportunities. All of these costs must ultimately be borne by
19 our customers.
20

21 **Q. HOW COULD A MANDATORY RFP REQUIREMENT LEAD TO LOST**
22 **OPPORTUNITIES AND INCREASE COST FOR CUSTOMERS?**
23

24 **A.** Mandating that competitive bidding be used exclusively to procure supply side resources
25 ignores the benefits that our customers receive when the Company has flexibility to procure
26 resources. There are occasions when a strictly applied, mandatory RFP rule would render
27 results detrimental to customers. For instance a power marketer could approach Duke with

1 a proposal to sell capacity to Duke at low cost, or a merchant generator could approach
2 Duke with a proposal to sell a plant or the output of certain units at a competitively
3 favorable price. If the utility were required to embark on a formal RFP process in order for
4 the utility to purchase capacity that is clearly very low cost, the opportunity to purchase the
5 generation may be missed.

6
7 **Q. SHOULD RFPs HAVE PRESET, PRESCRIPTIVE EVALUATION**
8 **METHODOLOGIES FOR SELECTING FUTURE RESOURCE ADDITIONS?**
9

10 **A.** No. Utilities must be allowed discretion for the evaluation of bids through a competitive
11 solicitation. All RFPs for supply side resources are principally guided by the utility's
12 obligation to procure least cost and reliable resources. In conducting RFPs, the Company is
13 in the best position to determine how to consider and properly weight non-price factors such
14 as reliability of the purchased power offer, fuel diversity, generation mix, and transmission
15 constraints. The appropriate weighting of these factors is complex and can vary according
16 to circumstances prevailing at the time. As I discuss later in my testimony, the Commission
17 already has oversight of the Company's planning process through its review of the
18 Company's Annual Plan and reviews any purchase contracts through its authority over fuel
19 cases and general rate cases. There has been no justification made for a more formal
20 regulatory approach that will ultimately limit flexibility and opportunities and could likely
21 harm customers rather than help them. So it is important that the Company be allowed the
22 discretion to design and administer its RFPs and maintain flexibility in conducting the
23 evaluation.

1 **Q. ARE THERE DIFFERENCES IN THE KIND OF RESOURCES BEING SOUGHT**
2 **THAT IMPACT WHETHER AN RFP IS THE BEST VEHICLE FOR**
3 **IDENTIFYING RESOURCES?**

4
5 A. Duke Power views baseload capacity as fundamentally different from peaking and
6 intermediate capacity. There are two key concerns at this time with using the competitive
7 wholesale market for baseload generating capacity-- location of the baseload generating
8 capacity and the consequences of supplier default. These concerns have led Duke to
9 conclude that the RFP process is not appropriate for baseload capacity at the present time.
10 Duke Power will continue to evaluate this position and may ultimately determine that, if the
11 issues discussed below can be mitigated, use of the RFP process for baseload capacity may
12 be appropriate.

13 **Q. PLEASE EXPLAIN YOUR CONCERNS REGARDING LOCATION OF THE**
14 **RESOURCE.**

15
16 A. With regard to location, the Company has historically built its own baseload capacity
17 located within the Company's control area to serve our customers. This is because
18 generation outside the control area historically has been more subject to interruption due to
19 transmission constraints. In the past, the Company has contracted for peaking capacity
20 outside the control area, because peaking capacity is typically called upon very few hours of
21 the year and, therefore, the likelihood of interruption is minimized; on the other hand,
22 baseload generation could be called upon virtually every hour. While Duke Power has
23 depended upon peaking capacity contracts outside the control area, it has not done so to
24 date with regard to baseload capacity.

25 **Q. YOU MENTION RELIABILITY OF PURCHASED POWER OFFERS. PLEASE**
26 **EXPAND ON THAT AREA.**
27

1 **A.** I believe that reliability is a key factor in the consideration of any resource proposal.
2
3 Purchased power resources can be less reliable than owned resources. For instance, the
4 financial state of a third party bidder and the likelihood of delivery of power is a critical
5 factor when considering a resource proposal. A resource that is not reliable cannot be
6 dispatched when needed and is of little value to our customers regardless of the price bid
7 into the RFP. Duke Power has not had any significant reliability issues with its purchased
8 power contracts, but, clearly, any contemplation by the Commission to expand the use of
9 RFPs must consider reliability concerns.

10 With regard to supplier default, Duke Power believes that relying on purchased power for
11 baseload capacity could potentially impact the Company's ability to provide a reliable
12 electric supply. In the case of default of a peaking or intermediate capacity purchased-
13 power supplier, the capacity could likely be replaced reasonably quickly and economically.
14 However, a default of a baseload supplier would likely be harder to replace. And the
15 Company believes that the monetary damages available to the Company in the event of a
16 baseload supplier default would be a poor substitute for the electricity the supplier had
17 contracted to provide.

18 **Q. HOW DOES DUKE POWER ENSURE THAT ANY FUTURE BASELOAD**
19 **ADDITIONS ARE COMPETITIVELY PRICED?**

20 **A.** The Company would make a decision to add new baseload resources after conducting its
21 rigorous least cost integrated resource planning process. As I discussed previously, Duke
22 Power believes at this time that baseload resources should be located within Duke Power's
23 control area and owned by Duke Power for its customers to receive the greatest benefit.
24 Just because baseload additions are not currently selected as part of an RFP process,

1 however, does not mean that they are not competitively priced. In fact, Duke Power would
2 competitively bid all major components of a new baseload plant to serve our customers.

3
4 **Q. PLEASE EXPLAIN THE PROCESS THAT DUKE UTILIZES CURRENTLY TO**
5 **DETERMINE THE LEAST COST MOST RELIABLE RESOURCE TO MEET ITS**
6 **CUSTOMERS NEEDS IN SOUTH CAROLINA?**

- 7
8 • **A.** As part of our integrated resource planning process, the Company makes
9 resource decisions predicated upon identifying the cost and the non-price
10 characteristics of proposed resources, and then selects resources that minimize the
11 total cost for our customers. At times the Company has utilized RFPs to determine
12 if purchased power can meet the resource needs. I attach as Exhibit 1 a list of
13 Duke's RFPs over the past ten years. During this timeframe, only peaking capacity
14 resources have been needed. The Company has issued RFPs to determine the
15 availability of market options to satisfy these resource needs. The responses to the
16 RFPs were compared to Duke "self build" options. As noted in the attached Exhibit,
17 Duke selected purchased power options bid into the RFPs in all but one case. Thus,
18 Duke has had good results for our customers as a result of using RFPs for certain
19 types of capacity needs, and we plan to continue using the RFP method where
20 appropriate. Indeed, the Company is currently evaluating the results on an RFP
21 issued this Spring to meet peaking and intermediate needs for 2007 of 350 MW and
22 up to 1500 MW for 2009 and beyond.

1 **Q. UNDER THE CURRENT REGULATORY PROCESS, CAN THE COMMISSION**
2 **ADEQUATELY MONITOR THE RESOURCE DECISIONS OF THE COMPANY?**

3
4 **A.** Yes. Under the current process the Commission has checks in place to ensure that the
5 resource decisions of the Company are prudent. Duke files an Annual Plan annually that
6 outlines its capacity needs and how it is meeting or plans to meet those needs. The breadth
7 of information provided to the Commission is guided by the Commission's Order No. 98-
8 502 from Docket 87-223-E, Least Cost Planning Procedures for Electric Utilities under the
9 Jurisdiction of the Public Service Commission of South Carolina. In Order 98-502, the
10 Commission provided that the Annual Plan must include:

- 11 1. The demand and energy forecast for at least a 15-year period.
12
13 2. The supplier's or producers' program for meeting the requirements shown
14 in its forecast in an economic and reliable manner, including both demand-
15 side and supply-side options.
16
17 3. A brief description and summary of cost-benefit analysis, if available, of
18 each option, which was considered, including those not selected.
19
20 4. The supplier's and producer's assumptions and conclusions with respect
21 to the effect of the plan on the cost and reliability of energy service, and a
22 description of the external, environmental and economic consequences of the
23 plan to the extent practicable
24

25 In addition, the Commission issued certain guidelines for the consideration process of long-
26 term wholesale power options in Docket No. 93-231-E, Proceeding Regarding
27 Consideration of Certain Standards Pertaining to Wholesale Power Purchases Pursuant to §
28 712 of the Energy Policy Act of 1992. Utilities must also obtain a certificate of
29 environmental compatibility and public convenience and necessity for any generation it
30 plans to construct within the State of South Carolina. Finally, the Commission has the

1 authority within a fuel clause or ratemaking proceeding to address the prudence of the
2 utility's actions in constructing a new plant or making power purchases.

3
4 **Q. IS THERE A CONSENSUS UPON THE VARIOUS JURISDICTIONS ON**
5 **MANDATING THE USE OF RFPs FOR EACH NEW RESOURCE ADDITION?**

6
7 **A.** No, there is no consensus that RFPs should be used for each and every new resource
8 addition. In some jurisdictions, such as Mississippi, North Carolina, Oklahoma, Kentucky
9 and West Virginia, there are no guidelines or rules mandating the use of a formalized RFP
10 process. Other jurisdictions, such as Indiana, Kansas, Montana, Tennessee and Utah have
11 provided guidelines for the procurement of supply-side resources through RFPs, but do not
12 mandate an RFP for each new resource addition. Even within the jurisdictions that
13 generally endorse the use of RFPs, there are safety nets, such as limits on the percentage of
14 purchased power that a utility can acquire, and initiatives that encourage the development of
15 self-build facilities.

16 Recently, Arkansas, which is referenced in the underlying docket which lead to this
17 proceeding by Columbia Energy witness Dismukes (Docket No. 2004-178-E (**Ex. 1**),
18 considered the issue of whether an RFP process should be mandated and took no action to
19 implement rules or guidelines. In 2003, the Arkansas Public Service Commission opened a
20 docket to address the creation of comprehensive resource planning guidelines and sought
21 input from interested parties on structuring a competitive procurement process. However,
22 after receiving such information, it suspended the procedural schedule and has issued no
23 rules or guidelines as a result of that docket.

24
25 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION.**

1 **A.** For all of the reasons stated in my testimony Duke recommends the following:
2 (1) that the Commission refrain from adopting any mandatory requirements for the issuance
3 of RFPs for future resource additions. Duke's approach to resource acquisitions already
4 incorporates the use of RFPs as reflected by our willingness to utilize RFPs over the past 10
5 years. Additionally Duke avails itself of the market when the market provides benefits to
6 our customers. Thus, no mandatory RFP requirement is needed nor justified.
7 (2) that the Commission not adopt any rules or guidelines that would formally structure the
8 RFP process. As provided in my testimony, such an approach would diminish the
9 flexibility of the Company and could prevent the Company from taking advantage of
10 opportunities in the marketplace for the benefit of customers.
11 (3) finally, that the Commission continue to use the significant regulatory mechanisms it
12 currently has in place to oversee resource planning and to determine the prudence of
13 resource selections made by the utilities it regulates.

14 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

15 **A.** Yes.
16
17

Brief Summary of Duke Power RFPs

<u>Request for Proposals (RFP)</u>	<u>Requested Amount</u>	<u>Responses</u>
<u>Outcome / Results</u>		
1995 RFP	Up to 675 MW for 1998 through 2001 (Short-Term Request) Up to 300 MW for 1998 through at minimum 2003 (Long-Term Request)	Four Short-Term responses Twelve Long-Term responses
1997 RFP	Up to 250 MW by 1998 and up to 1100 Mw by 2002.	Six responses
2000 RFP Phase I	Up to 2900 MW by 2004	Fourteen responses
2000 RFP Phase II	Included in 2000 RFP Phase 1	Included in 2000 RFP Phase 1
2003 RFP	Up to 500 MW in 2005 and up to 1500 MW by 2009	Twenty-six responses